NOVANTA INC
Form 10-Q
November 01, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 29, 2017

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File No. 001-35083

Novanta Inc.

(Exact name of registrant as specified in its charter)

New Brunswick, Canada (State or other jurisdiction of incorporation or organization)	98-0110412 (I.R.S. Employer Identification No.)
125 Middlesex Turnpike	
Bedford, Massachusetts, USA (Address of principal executive offices)	01730 (Zip Code)

(781) 266-5700

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 27, 2017, there were 34,592,138 of the Registrant's common shares, no par value, issued and outstanding.

NOVANTA INC.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

NOVANTA INC.

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars or shares)

(Unaudited)

	September 29, 2017	December 31, 2016
ASSETS		
Current assets		
Cash and cash equivalents	$ 92,149	$ 68,108
Accounts receivable, net of allowance of $782 and $565, respectively	83,008	63,769
Inventories	88,861	59,745
Prepaid income taxes and income taxes receivable	8,107	2,058
Prepaid expenses and other current assets	8,253	5,570
Total current assets	280,378	199,250
Property, plant and equipment, net	60,244	35,421
Deferred tax assets	11,772	8,593
Other assets	4,256	12,502
Intangible assets, net	157,938	61,743
Goodwill	207,720	108,128
Total assets	$ 722,308	$ 425,637
LIABILITIES, NONCONTROLLING INTEREST AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	$ 9,115	$ 7,366
Accounts payable	39,666	32,213
Income taxes payable	6,086	3,969
Accrued expenses and other current liabilities	40,940	26,948
Total current liabilities	95,807	70,496
Long-term debt	234,188	70,554
Deferred tax liabilities	27,106	1,294
Income taxes payable	4,154	5,710
Other liabilities	15,068	18,713
Total liabilities	376,323	166,767
Commitments and contingencies (Note 13)		
Redeemable noncontrolling interest	36,838	—
Stockholders' equity:		
Common shares, no par value; Authorized shares: unlimited;	423,856	423,856

Issued and outstanding: 34,583 and 34,458, respectively		
Additional paid-in capital	32,283	30,276
Accumulated deficit	(127,660)	(167,547)
Accumulated other comprehensive loss	(19,332)	(27,715)
Total stockholders' equity	309,147	258,870
Total liabilities, noncontrolling interest and stockholders’ equity	$ 722,308	$ 425,637

The accompanying notes are an integral part of these consolidated financial statements.

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NOVANTA INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S. dollars or shares, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Revenue	$ 146,296	$ 97,829	$ 374,372	$ 285,879
Cost of revenue	87,589	56,617	216,082	166,279
Gross profit	58,707	41,212	158,290	119,600
Operating expenses:				
Research and development and engineering	11,659	7,961	29,878	24,029
Selling, general and administrative	27,724	20,972	74,666	62,357
Amortization of purchased intangible assets	3,217	2,066	9,413	6,153
Restructuring, acquisition and divestiture related costs (gain)	3,834	(835)	6,232	5,828
Total operating expenses	46,434	30,164	120,189	98,367
Operating income from continuing operations	12,273	11,048	38,101	21,233
Interest income (expense), net	(2,111)	(1,081)	(4,874)	(3,471)
Foreign exchange transaction gains (losses), net	(661)	188	(176)	978
Other income (expense), net	(4)	686	104	1,699
Gain on acquisition of business	—	—	26,409	—
Income from continuing operations before income taxes	9,497	10,841	59,564	20,439
Income tax provision	1,131	3,371	6,934	6,192
Income from continuing operations	8,366	7,470	52,630	14,247
Loss from discontinued operations, net of tax	—	—	—	—
Consolidated net income	8,366	7,470	52,630	14,247
Less: Net income attributable to noncontrolling interest	(834)	—	(1,444)	—
Net income attributable to Novanta Inc.	$ 7,532	$ 7,470	$ 51,186	$ 14,247
Earnings (loss) per common share from continuing operations (Note 5):				
Basic	$ (0.00)	$ 0.22	$ 1.15	$ 0.41
Diluted	$ (0.00)	$ 0.21	$ 1.13	$ 0.41
Loss per common share from discontinued operations (Note 5):				
Basic	$ —	$ —	$ —	$ —
Diluted	$ —	$ —	$ —	$ —
Earnings (loss) per common share attributable to Novanta Inc. (Note 5):				
Basic	$ (0.00)	$ 0.22	$ 1.15	$ 0.41
Diluted	$ (0.00)	$ 0.21	$ 1.13	$ 0.41
Weighted average common shares outstanding—basic	34,833	34,677	34,809	34,689

Weighted average common shares outstanding—diluted	34,833	34,928	35,235	34,889

The accompanying notes are an integral part of these consolidated financial statements.

NOVANTA INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands of U.S. dollars)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Consolidated net income	$ 8,366	$ 7,470	$ 52,630	$ 14,247
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax (1)	3,311	(563)	8,340	(3,413)
Pension liability adjustments, net of tax (2)	(45)	338	43	1,633
Total other comprehensive income (loss)	3,266	(225)	8,383	(1,780)
Total consolidated comprehensive income (loss)	11,632	7,245	61,013	12,467
Less: Comprehensive income attributable to noncontrolling interest	(834)	—	(1,444)	—
Comprehensive income (loss) attributable to Novanta Inc.	$ 10,798	$ 7,245	$ 59,569	$ 12,467

(1) The tax effect on this component of comprehensive income was nominal for all periods presented.

(2) The tax effect on this component of comprehensive income was nominal for all periods presented. See Note 4 for the total amount of pension liability adjustments reclassified out of accumulated other comprehensive income (loss).

The accompanying notes are an integral part of these consolidated financial statements.

NOVANTA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	Nine Months Ended	
	September 29, 2017	September 30, 2016
Cash flows from operating activities:		
Consolidated net income	$ 52,630	$ 14,247
Less: Loss from discontinued operations, net of tax	—	—
Income from continuing operations	52,630	14,247
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	22,440	15,317
Provision for inventory excess and obsolescence	1,837	2,387
Share-based compensation	4,223	3,385
Deferred income taxes	(2,913)	162
Earnings from equity-method investment	(104)	(1,698)
Gain on sale of fixed assets	21	(1,736)
Dividend from equity-method investment	—	2,341
Gain on acquisition of business	(26,409)	—
Inventory acquisition fair value adjustment	4,754	173
Contingent consideration adjustments	425	1,427
Other	851	1,417
Changes in assets and liabilities which (used)/provided cash, excluding effects from businesses purchased or classified as discontinued operations:		
Accounts receivable	(3,859)	(3,683)
Inventories	(11,806)	(1,470)
Prepaid income taxes, income taxes receivable, prepaid expenses and other current assets	(5,806)	(3,594)
Accounts payable, income taxes payable, accrued expenses and other current liabilities	5,975	6,110
Other non-current assets and liabilities	(972)	(78)
Cash provided by operating activities of continuing operations	41,287	34,707
Cash provided by operating activities of discontinued operations	—	—
Cash provided by operating activities	41,287	34,707
Cash flows from investing activities:		
Purchases of property, plant and equipment	(6,502)	(7,005)
Acquisition of businesses, net of cash acquired and working capital adjustments	(168,332)	(8,952)
Proceeds from the sale of property, plant and equipment	44	7,037
Cash used in investing activities of continuing operations	(174,790)	(8,920)
Cash provided by investing activities of discontinued operations	—	1,498

Cash used in investing activities	(174,790)	(7,422)
Cash flows from financing activities:		
Borrowings under revolving credit facility	176,769	—
Repayments of long-term debt and revolving credit facility	(15,625)	(14,375)
Payments for debt issuance costs	(638)	(2,496)
Payments of contingent considerations	(2,546)	—
Repurchase of common stock	(370)	(1,634)
Payments of withholding taxes from stock-based awards	(1,846)	(1,719)
Capital lease payments	(646)	(905)
Other financing activities	—	(1)
Cash provided by (used in) financing activities of continuing operations	155,098	(21,130)
Cash provided by (used in) financing activities of discontinued operations	—	—
Cash provided by (used in) financing activities	155,098	(21,130)
Effect of exchange rates on cash and cash equivalents	2,446	(1,375)
Increase in cash and cash equivalents	24,041	4,780
Cash and cash equivalents, beginning of period	68,108	59,959
Cash and cash equivalents, end of period	$ 92,149	$ 64,739
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 3,512	$ 2,167
Cash paid for income taxes	$ 18,053	$ 10,870
Income tax refunds received	$ 185	$ 359

The accompanying notes are an integral part of these consolidated financial statements.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 29, 2017

(Unaudited)

1. Basis of Presentation

Novanta Inc. and its subsidiaries (collectively referred to as the “Company”, “Novanta”, “we”, “us”, “our”) is a global supplier core technology solutions that give healthcare and advanced industrial original equipment manufacturers (“OEMs”) a competitive advantage. Novanta combines deep proprietary technology expertise and competencies in photonics, vision and precision motion with a proven ability to solve complex technical challenges. This enables Novanta to engineer core components and sub-systems that deliver extreme precision and performance, tailored to customers' demanding applications.

The accompanying unaudited interim consolidated financial statements have been prepared in U.S. dollars and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”), the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The interim consolidated financial statements and notes included in this report should be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary to fairly state the results of the interim periods presented. The results for interim periods are not necessarily indicative of results to be expected for the full year or for any future periods.

Prior to January 10, 2017, the Company had an approximately 41% ownership interest in Laser Quantum Limited (“Laser Quantum”), a privately held company located in the United Kingdom, which was accounted for under the equity method of accounting. On January 10, 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum. As a result of this transaction, the Company’s ownership position in Laser Quantum increased from approximately 41% to approximately 76%. Since January 10, 2017, Laser Quantum has been consolidated in the Company’s consolidated financial statements.

The Company’s unaudited interim financial statements are prepared for each quarterly period ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. The Company evaluates its estimates based on historical experience, current conditions and various other assumptions that it believes are reasonable under the circumstances. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which they are deemed to be necessary. Actual results could differ significantly from those estimates.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 29, 2017

(Unaudited)

Recent Accounting Pronouncements

Share-Based Compensation

In May 2017, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2017-09, "Compensation – Stock Compensation (Topic 718)," which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. ASU 2017-09 requires that an entity account for the effects of a modification unless (i) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; (ii) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (iii) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. ASU 2017-09 will become effective prospectively for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The Company does not expect the adoption of ASU 2017-09 to have a material impact on its consolidated financial statements.

Presentation of Net Periodic Pension Cost

In March 2017, the FASB issued ASU 2017-07, "Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which requires employers that offer or maintain defined benefit plans to disaggregate the service component from the other components of net benefit cost and provides guidance on the presentation of the service component and the other components of net benefit cost in the statement of operations. The new standard is effective for public companies for annual periods beginning after December 15, 2017. The Company expects to adopt the new standard in the first quarter of 2018 and expects to report its net periodic pension cost related to its frozen U.K. pension plan, consisting of interest cost, expected return on plan assets and amortization of actuarial gains (losses) only, in Other income (expense) in the consolidated statement of operations upon adoption.

Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which simplifies the accounting for goodwill impairment. The amendment in ASU 2017-04 removes Step-two of the goodwill impairment test, which requires a hypothetical purchase price allocation. ASU 2017-04 will become effective prospectively for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact of the new standard on its consolidated financial statements.

Statement of Cash Flows Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." The standard further clarifies the classification in the cash flow statement of the following items: (i) debt prepayment or debt extinguishment costs; (ii) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; (iii) contingent consideration payments made after a business combination; (iv) proceeds from the settlement of insurance claims; (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (vi) distributions received from equity method investees; (vii) beneficial interests in securitization transactions; and (viii) separately identifiable cash flows and application of the predominance principle. ASU 2016-15 will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. ASU 2016-15 should be applied using a retrospective transition method for each period presented. The Company adopted ASU 2016-15 during the first quarter of 2017. The adoption of ASU 2016-15 resulted in ($2.5) million of payments of contingent considerations being reported as cash used in financing activities on the Company's consolidated statements of cash flows for the nine months ended September 29, 2017.

Leases

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," which provides comprehensive lease accounting guidance. The standard requires entities to recognize lease assets and liabilities on the balance sheet and to disclose key information about leasing arrangements. ASU 2016-02 will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the potential impact of this guidance and an appropriate implementation strategy. While the Company's evaluation of this guidance is in the early stages, the Company currently expects adoption of this guidance to have an impact on its consolidated balance sheet.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)," which provides guidance for revenue recognition. ASU 2014-09 supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, "Revenue Recognition (Topic 605)," and requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 would be effective for annual and interim reporting periods beginning after December 15, 2016 and did not allow early adoption. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date," which deferred the effective date of ASU 2014-09 by one year to December 15, 2017, with the option of early adoption as of the original effective date. The amendment in ASU 2015-14 resulted in ASU 2014-09 becoming effective for annual and interim reporting periods beginning after December 15, 2017. Upon adoption of Topic 606, an entity may apply the new guidance either retrospectively to each prior reporting period presented (the "full retrospective method") or retrospectively only to customer contracts not yet completed as of the date of adoption with the cumulative effect of initially applying the standard recognized in beginning retained earnings at the date of the initial application (the "modified retrospective method").

The Company will adopt the new standard as of January 1, 2018 and has conducted various activities to prepare for the adoption of the new standard. The Company surveyed cross-functional leaders to identify potential revenue streams that could be impacted by Topic 606 and identified certain revenue streams that could be impacted. The Company also reviewed a representative sample of individual customer contracts related to these various revenue streams to determine if the guidance under Topic 606 is expected to have a material impact on revenue recognition.

The Company's work to date indicates that only a limited number of contracts with customers may require a change in the way revenues are recognized. The Company is still in the process of determining the expected quantitative impact that the adoption of Topic 606 will have on its consolidated financial statements.

The Company concluded that it will adopt the new standard using the modified retrospective method. In addition, the Company will elect to apply certain practical expedients allowed under the guidance. First, the Company does not intend to adjust the promised amount of consideration for the effects of a financing component as the transfer of a promised good to a customer and the customer's payment for that good are typically expected to be one year or less. Second, the Company will exclude from its transaction price any amounts collected from customers for all sales or other similar taxes, which is consistent with the Company's current practice. Third, the Company will elect to account for shipping and handling activities that occur after the transfer of control over the related goods as fulfillment activities rather than performance obligations.

2. Business Combinations

WOM

On July 3, 2017, the Company acquired 100% of the outstanding shares of W.O.M. World of Medicine GmbH ("WOM"), a Berlin, Germany-based provider of medical insufflators, pumps, and related disposables for OEMs in the minimally invasive surgical market, for a total purchase price of €118.1 million ($134.9 million), net of working capital adjustments. The acquisition was financed with a €118.0 million ($134.7 million) draw-down on the Company's revolving credit facility. The Company expects that the addition of WOM will help the Company to better serve customers in minimally invasive surgery applications with a broader range of product offerings. WOM is included in the Company's Vision reportable segment.

The acquisition of WOM has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets acquired and liabilities assumed. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of WOM and the Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The Company's estimates and assumptions in determining the estimated fair values of certain assets and liabilities are subject to change within the measurement period (up to one year from the acquisition date) as a result of additional information obtained with regard to facts and circumstances that existed as of the acquisition date. The purchase price allocation is preliminary as the Company is in the process of collecting additional information for the valuation of inventory, property and equipment, intangible assets, accrued liabilities and unrecognized tax benefits.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 29, 2017

(Unaudited)

Based upon a preliminary valuation, the total purchase price allocation is as follows (in thousands):

	Purchase Price Allocation
Cash	$ 1,400
Accounts receivable	11,807
Inventories	14,549
Property and equipment	21,940
Intangible assets	59,732
Goodwill	53,775
Other assets	2,660
Total assets acquired	165,863
Accounts payable	4,398
Other liabilities	8,276
Deferred tax liabilities	18,255
Total liabilities assumed	30,929
Total assets acquired, net of liabilities assumed	134,934
Less: cash acquired	1,400
Total purchase price, net of cash acquired	$ 133,534

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	$ 21,586	10 years
Customer relationships	34,949	12 years
Trademarks and trade names	2,284	10 years
Backlog	913	1 year
Total	$ 59,732	

The purchase price allocation resulted in $59.7 million of identifiable intangible assets and $53.8 million of goodwill. As the WOM acquisition is an acquisition of outstanding common shares, none of the resulting goodwill is deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flows potentially attributable to: (i) WOM's ability to grow its business with existing and new customers, including leveraging the Company's customer base; and (ii) cost improvements due to expansion in scale.

The operating results of WOM were included in the Company's results of operations beginning on July 3, 2017. WOM contributed revenues of $24.8 million and an operating loss from continuing operations before income taxes of $1.6 million for the nine months ended September 29, 2017. Operating loss from continuing operations before income taxes for the nine months ended September 29, 2017 included amortization of inventory fair value adjustments and amortization of purchased intangible assets of $4.9 million.

ThingMagic

On January 10, 2017, the Company acquired from Trimble Inc. certain assets and liabilities that constituted the business of ThingMagic, a Woburn, Massachusetts-based provider of ultra-high frequency ("UHF") radio frequency identification ("RFID") modules and finished RFID readers to OEMs in the medical and advanced industrial markets, for a total purchase price of $19.1 million, net of working capital adjustments. The acquisition was financed with cash on hand and a $12.0 million draw-down on the Company's revolving credit facility. The Company expects that the addition of ThingMagic will broaden its portfolio of RFID

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 29, 2017

(Unaudited)

solutions, while providing the resources to address the growing need for improvements in workflow solutions, patient safety, anti-counterfeiting, and asset tracking in a medical environment. ThingMagic is included in the Company's Vision reportable segment.

The acquisition of ThingMagic has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets and liabilities acquired. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of ThingMagic and the Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The Company's estimates and assumptions in determining the estimated fair values of certain assets and liabilities are subject to change within the measurement period (up to one year from the acquisition date) as a result of additional information obtained with regards to facts and circumstances that existed as of the acquisition date.

Based upon a preliminary valuation, the total purchase price was allocated as follows (in thousands):

	Purchase Price Allocation
Inventories	$ 1,832
Intangible assets	7,423
Goodwill	9,929
Total assets acquired	19,184
Other liabilities	95
Total liabilities assumed	95
Total purchase price	$ 19,089

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	$ 4,600	10 years
Customer relationships	2,520	10 years

Trademarks and trade names	303	5 years
Total	$ 7,423	

The purchase price allocation resulted in $7.4 million of identifiable intangible assets and $9.9 million of goodwill. As the ThingMagic acquisition is treated as an acquisition of assets for income tax purposes, the goodwill acquired is expected to be fully deductible. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flows potentially attributable to: (i) ThingMagic's ability to grow its business with existing and new customers, including leveraging the Company's customer base; (ii) cost synergies in combining the research and development capabilities from ThingMagic with the existing RFID capabilities within Novanta; and (iii) cost improvements due to the integration of ThingMagic operations into the Company's existing infrastructure.

The operating results of ThingMagic were included in the Company's results of operations beginning on January 10, 2017. ThingMagic contributed revenues of $6.5 million and operating income from continuing operations before income taxes of $0.1 million for the nine months ended September 29, 2017. Operating income from continuing operations before income taxes for the nine months ended September 29, 2017 included amortization of inventory fair value adjustments and amortization of purchased intangible assets of $1.2 million.

The pro forma financial information reflecting the operating results of ThingMagic, as if it had been acquired as of January 1, 2016, would not differ materially from the operating results of the Company as reported for the year ended December 31, 2016.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 29, 2017

(Unaudited)

Laser Quantum Limited

On January 10, 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum, a Manchester, United Kingdom-based provider of solid state continuous wave lasers, femtosecond lasers, and optical light engines to OEMs in the medical market, for £25.5 million ($31.1 million) in cash consideration. The purchase price was financed with cash on hand and a $30.0 million draw-down on the Company's revolving credit facility. As a result of this transaction, the Company's ownership position in Laser Quantum increased from approximately 41% to approximately 76%. By establishing control through a majority equity ownership, the Company expects to broaden its technology capability in photonics solutions for medical applications, particularly within the growing DNA sequencing market, while providing key enabling photonics-based technologies for instrumentation and life science applications such as biomedical imaging, cell sorting, and ophthalmology. Laser Quantum is included in the Company's Photonics reportable segment.

As part of this transaction, the Company and the remaining shareholders of Laser Quantum entered into a call and put option agreement for the purchase and sale, in 2020, of all remaining Laser Quantum shares held by the other shareholders, subject to certain conditions. The purchase price for the remaining shares will be based on the proportionate share of the noncontrolling interest ("NCI") in Laser Quantum's cash on hand as of December 31, 2019 and a multiple of Laser Quantum's EBITDA for the twelve months ending December 31, 2019, as defined in the call and put option agreement.

In connection with the purchase price allocation, upon gaining control over Laser Quantum, the Company recognized a nontaxable gain of $26.4 million in the consolidated statement of operations for the nine months ended September 29, 2017. The gain represented the excess of the fair value of the Company's previously-held equity interest in Laser Quantum over its carrying value upon gaining control.

The fair value of the approximately 41% equity interest previously held by the Company before the acquisition and the fair value of the approximately 24% NCI held by the remaining shareholders of Laser Quantum after the acquisition were determined using a combination of the discounted cash flow method (an income approach), the guideline public company method (a market approach), and the subject company transaction method (a market approach). The subject company transaction method was based on the purchase price paid by the Company for the acquisition of the additional approximately 35% of the outstanding shares, while giving consideration to the control and/or minority nature of the subject equity interests.

The acquisition of Laser Quantum has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets and liabilities acquired. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of Laser Quantum and the Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The Company's estimates and assumptions in determining the estimated fair values of certain assets and liabilities are subject to change within the measurement period (up to one year from the acquisition date) as a result of additional information to be obtained with regards to facts and circumstances that existed as of the acquisition date.

Based upon a preliminary valuation, the total purchase price was allocated as follows (in thousands):

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	Purchase Price Allocation
Cash	$ 15,343
Accounts receivable	2,739
Inventories	6,264
Property and equipment	2,286
Intangible assets	38,955
Goodwill	31,041
Other assets	717
Total fair value of assets	97,345
Accounts payable	796
Other liabilities	2,068
Deferred tax liabilities	7,210
Total fair value of liabilities	10,074
Total fair value of assets, net of fair value of liabilities	87,271
Less: fair value of equity interest previously held by Novanta	34,637
Less: fair value of noncontrolling interest	21,582
Total purchase price paid by Novanta	31,052
Less: cash acquired	15,343
Purchase price, net of cash acquired	$ 15,709

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	$ 15,501	15 years
Customer relationships	19,990	15 years
Trademarks and trade names	1,964	15 years
Backlog	1,500	9 months
Total	$ 38,955	

The purchase price allocation resulted in $39.0 million of identifiable intangible assets and $31.0 million of goodwill. As the Laser Quantum acquisition is an acquisition of outstanding common shares, none of the resulting goodwill is deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flow potential attributable to: (i) Laser Quantum's ability to grow its business with existing and new customers, including leveraging the Company's broader customer base; and (ii) cost improvements due to expansion in scale.

The operating results of Laser Quantum were included in the Company's results of operations beginning on January 10, 2017. Laser Quantum contributed revenues of $32.3 million and income from continuing operations before income taxes of $7.0 million for the nine months ended September 29, 2017. Operating income from continuing operations before income taxes for the nine months ended September 29, 2017 included $5.8 million of expenses associated with the amortization of inventory fair value step-up and purchased intangible assets.

Unaudited Pro Forma Information

The pro forma information for all periods presented below includes the effects of business combination accounting resulting from the acquisitions of WOM and Laser Quantum, including amortization of inventory fair value adjustments, amortization of intangible assets, interest expense on borrowings in connection with the acquisition, elimination of the gain from business acquisition and income from equity method investment, and the related tax effects as though the acquisitions had been consummated as of

NOVANTA INC.

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January 1, 2016. The pro forma financial information is presented for comparative purposes only and is not necessarily indicative of the results of operations that actually would have been achieved if the acquisitions had taken place on January 1, 2016.

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Revenue	$146,296	$ 124,925	$415,900	$ 361,701
Income from continuing operations	$12,727	$ 8,241	$32,038	$ 12,804
Earnings per common share attributable to Novanta Inc. - Basic	$0.12	$ 0.24	$0.55	$ 0.36
Earnings per common share attributable to Novanta Inc. - Diluted	$0.12	$ 0.24	$0.55	$ 0.36

Acquisition Costs

Acquisition-related costs are included in restructuring, acquisition and divestiture related costs in the consolidated statements of operations. Acquisition-related costs for WOM, ThingMagic and Laser Quantum are as follows (in thousands):

	Three Months Ended September 29, 2017	Nine Months Ended September 29, 2017
ThingMagic	$ —	$ 149
Laser Quantum	$ —	$ 264
WOM	$ 3,359	$ 4,351

3. Discontinued Operations and Divestitures

In July 2014, the Company completed the sale of certain assets and liabilities of its Scientific Lasers business for approximately $6.5 million in cash, net of working capital adjustments. In accordance with the purchase and sale agreement, $1.5 million of the sales proceeds was held in escrow until January 2016. In January 2016, the $1.5 million escrow was released to the Company in full and is reported as cash flow from investing activities of discontinued operations.

4. Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) was as follows (in thousands):

	Total accumulated other comprehensive income (loss)	Foreign currency translation adjustments	Pension liabilities
Balance at December 31, 2016	$ (27,715)	$ (17,222)	$ (10,493)
Other comprehensive income (loss)	7,509	8,340	(831)
Amounts reclassified from other comprehensive income (loss) [(1)]	874	—	874
Balance at September 29, 2017	$ (19,332)	$ (8,882)	$ (10,450)

(1) The amounts reclassified from other comprehensive income (loss) were included in selling, general and administrative expenses in the consolidated statements of operations.

5. Earnings (Loss) per Common Share

Basic earnings (loss) per common share is computed by dividing net income attributable to Novanta Inc. after adjustment of redeemable noncontrolling interest to estimated redemption value by the weighted average number of common shares outstanding

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NOVANTA INC.

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during the period. The Company recognizes changes in the redeemable noncontrolling interest redemption value by adjusting the carrying amount of the redeemable noncontrolling interest as of the end of the period to the higher of: (i) the estimated redemption value assuming the end of the period is also the redemption date or (ii) the carrying value without any redemption value adjustments. Such adjustments are recorded in retained earnings in stockholders' equity instead of net income attributable to Novanta Inc. For both basic and diluted earnings (loss) per common share, such redemption value adjustments are included in the calculation of the numerator. For diluted earnings (loss) per common share, the denominator also includes the dilutive effect of outstanding restricted stock units, stock options and total shareholder return performance restricted stock units determined using the treasury stock method. Dilutive effects of contingently issuable shares are included in the weighted average dilutive share calculation using the treasury stock method when the contingencies have been resolved. For periods in which net losses are generated, the dilutive potential common shares are excluded from the calculation of diluted earnings per common share as the effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings (loss) per common share (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Numerators:				
Income from continuing operations	$ 8,366	$ 7,470	$ 52,630	$ 14,247
Less: Net income attributable to noncontrolling interest	(834)	—	(1,444)	—
Net income attributable to Novanta Inc.	7,532	7,470	51,186	14,247
Less: Adjustment of redeemable noncontrolling interest to estimated redemption value (see Note 14)	(7,585)	—	(11,303)	—
Net income (loss) attributable to Novanta Inc. after adjustment of redeemable noncontrolling interest to estimated redemption value	$ (53)	$ 7,470	$ 39,883	$ 14,247
Denominators:				
Weighted average common shares outstanding— basic	34,833	34,677	34,809	34,689
Dilutive potential common shares (1)	—	251	426	200
Weighted average common shares outstanding— diluted	34,833	34,928	35,235	34,889
Antidilutive common shares excluded from above	—	144	—	112
Basic Earnings (Loss) per Common Share:				
Basic earnings (loss) per common share attributable to Novanta Inc.	$ (0.00)	$ 0.22	$ 1.15	$ 0.41
Diluted Earnings (Loss) per Common Share:				

Diluted earnings (loss) per common share attributable to Novanta Inc.	$ (0.00)	$ 0.21	$ 1.13	$ 0.41

(1) Due to the Company's net loss position after adjustment of redeemable noncontrolling interest to estimated redemption value for the three months ended September 29, 2017, all potentially dilutive shares are excluded from the calculation of the denominator as their effect would have been anti-dilutive.

Common Share Repurchases

During the nine months ended September 29, 2017, the Company repurchased 14 thousand of its common shares in the open market for an aggregate purchase price of $0.4 million at an average price of $26.41 per share.

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6. Fair Value Measurements

ASC 820, "Fair Value Measurements," establishes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

- Level 1: Quoted prices for identical assets or liabilities in active markets which the Company can access.
- Level 2: Observable inputs other than those described in Level 1.
- Level 3: Unobservable inputs.

The Company's cash equivalents are investments in money market accounts, which represent the only asset the Company measures at fair value on a recurring basis. The Company determines the fair value of cash equivalents using a market approach based on quoted prices in active markets. The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable and accrued expenses and other current liabilities (excluding contingent considerations) approximate their carrying values because of their short-term nature.

Contingent consideration

On December 18, 2015, the Company acquired all assets and certain liabilities of Skyetek Inc. ("Skyetek"). Under the purchase and sale agreement for the Skyetek acquisition, the owners of Skyetek were eligible to receive contingent consideration based on the achievement of certain sales order commitment targets from October 2015 through June 2017. The undiscounted range of possible contingent consideration was zero to $0.3 million. If such targets were achieved, the contingent consideration would be payable in 2017. The Company recognized an estimated fair value of $0.2 million as part of the purchase price as of the acquisition date. Based on the actual sales order commitments through June 2017, the Company paid $0.1 million as the final Skyetek contingent consideration during the three months ended September 29, 2017.

On November 11, 2015, the Company acquired Lincoln Laser Company ("Lincoln Laser"). Under the purchase and sale agreement for the Lincoln Laser acquisition, the shareholders of Lincoln Laser were eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal year 2016. The estimated fair value of the contingent consideration of $2.3 million was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. Based on Lincoln Laser's fiscal year 2016 revenue results, the fair value of the contingent consideration for Lincoln Laser was adjusted to $1.4 million as of December 31, 2016. The Company paid $1.4 million as final settlement of the contingent consideration in the first quarter of 2017.

On February 19, 2015, the Company acquired Applimotion Inc. ("Applimotion"). Under the purchase and sale agreement for the Applimotion acquisition, the shareholders of Applimotion are eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal years 2015 to 2017. The undiscounted range of contingent considerations is zero to $4.0 million. If such targets are achieved, the contingent consideration will be payable in cash in two installments in 2017 and 2018, respectively. The estimated fair value of the contingent consideration of $1.0 million was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. Subsequent changes in the estimated fair value of this contingent liability are recorded in the consolidated statement of operations in restructuring, acquisition and divestiture related costs until the liability is fully settled. Under the Monte Carlo valuation method, the fair value of the contingent consideration for Applimotion was $3.6 million as of December 31, 2016. Based on Applimotion's revenue performance for 2015 and 2016, the Company paid $1.2 million in contingent consideration in the first quarter of 2017. Based on the strong revenue performance year to date and projections for the remainder of 2017, the Company adjusted the fair value for the remaining contingent consideration to $2.8 million, which is reported as a current liability in accrued expenses and other current liabilities on the consolidated balance sheet as of September 29, 2017. The second installment of the contingent consideration will be payable in the first quarter of 2018.

The following table summarizes the fair values of the Company's financial assets and liabilities as of September 29, 2017 (in thousands):

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	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	$ 3,141	$ 3,141	$ —	$ —
Liabilities				
Contingent consideration - Current	$ 2,800	$ —	$ —	$ 2,800
Contingent consideration - Long-term	—	—	—	—
	$ 2,800	$ —	$ —	$ 2,800

The following table summarizes the fair values of the Company's financial assets and liabilities as of December 31, 2016 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	$ 9,569	$ 9,569	$ —	$ —
Liabilities				
Contingent consideration - Current	$ 2,775	$ —	$ —	$ 2,775
Contingent consideration - Long-term	2,381	—	—	2,381
	$ 5,156	$ —	$ —	$ 5,156

Changes in the fair value of Level 3 contingent consideration during the nine months ended September 29, 2017 were as follows (in thousands):

	Contingent Consideration
Balance at December 31, 2016	$ 5,156
Payment to Applimotion	(1,200)
Payment to Lincoln Laser	(1,433)

Payment to Skyetek		(148)
Fair value adjustments (1)		425
Balance at September 29, 2017	$	2,800

(1) In the nine months ended September 29, 2017, the fair value of the contingent consideration in connection with the acquisition of Applimotion was increased by $0.4 million due to increased actual and projected revenue performance.

See Note 9 to Consolidated Financial Statements for a discussion of the estimated fair value of the Company's outstanding debt.

7. Goodwill and Intangible Assets

Goodwill

Goodwill is recorded when the consideration for a business combination exceeds the fair value of net tangible and identifiable intangible assets acquired. The Company tests its goodwill balances annually for impairment as of the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. The Company performed its annual goodwill impairment test as of the beginning of the second quarter of 2017 and noted no impairment of goodwill.

The following table summarizes changes in goodwill during the nine months ended September 29, 2017 (in thousands):

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

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Balance at beginning of the period	$108,128
Goodwill acquired from Laser Quantum acquisition	31,041
Goodwill acquired from ThingMagic acquisition	9,929
Goodwill acquired from WOM acquisition	53,775
Effect of foreign exchange rate changes	4,847
Balance at end of the period	$207,720

Goodwill by reportable segment as of September 29, 2017 was as follows (in thousands):

	Reportable Segment			
			Precision	
	Photonics	Vision	Motion	Total
Goodwill	$170,450	$154,536	$33,963	$358,949
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	$67,989	$122,814	$16,917	$207,720

Goodwill by reportable segment as of December 31, 2016 was as follows (in thousands):

	Reportable Segment			
			Precision	
	Photonics	Vision	Motion	Total
Goodwill	$136,278	$89,116	$33,963	$259,357
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	$33,817	$57,394	$16,917	$108,128

Intangible Assets

Intangible assets as of September 29, 2017 and December 31, 2016, respectively, are summarized as follows (in thousands):

	September 29, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable intangible assets:						
Patents and developed technologies	$129,059	$(74,456)	$54,603	$84,742	$(67,902)	$16,840
Customer relationships	130,311	(49,765)	80,546	69,554	(42,934)	26,620
Customer backlog	3,216	(2,273)	943	622	(540)	82
Non-compete covenant	2,514	(1,821)	693	2,514	(1,419)	1,095
Trademarks and trade names	15,644	(7,518)	8,126	10,709	(6,630)	4,079
Amortizable intangible assets	280,744	(135,833)	144,911	168,141	(119,425)	48,716
Non-amortizable intangible assets:						
Trade names	13,027	—	13,027	13,027	—	13,027
Totals	$293,771	$(135,833)	$157,938	$181,168	$(119,425)	$61,743

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All definite-lived intangible assets are amortized either on a straight-line basis or an economic benefit basis over their remaining useful life. Amortization expense for customer relationships and definite-lived trademarks, trade names and other intangibles is included in operating expenses in the accompanying consolidated statements of operations. Amortization expense for patents and developed technologies is included in cost of revenue in the accompanying consolidated statements of operations. Amortization expense is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Amortization expense – cost of revenue	$ 2,741	$ 994	$ 6,078	$ 3,163
Amortization expense – operating expenses	3,217	2,066	9,413	6,153
Total amortization expense	$ 5,958	$ 3,060	$ 15,491	$ 9,316

Estimated amortization expense for each of the five succeeding years and thereafter as of September 29, 2017 was as follows (in thousands):

Year Ending December 31,	Cost of Revenue	Operating Expenses	Total
2017 (remainder of year)	$ 2,755	$ 2,697	$ 5,452
2018	9,331	16,591	25,922
2019	8,474	14,625	23,099
2020	7,585	11,922	19,507
2021	6,703	10,708	17,411
Thereafter	19,755	33,765	53,520
Total	$ 54,603	$ 90,308	$ 144,911

8. Supplementary Balance Sheet Information

The following tables provide the details of selected balance sheet items as of the periods indicated (in thousands):

Inventories

	September 29, 2017	December 31, 2016
Raw materials	$ 55,418	$ 39,822
Work-in-process	13,272	8,012
Finished goods	16,634	9,511
Demo and consigned inventory	3,537	2,400
Total inventories	$ 88,861	$ 59,745

Accrued Expenses and Other Current Liabilities

	September 29, 2017	December 31, 2016
Accrued compensation and benefits	$ 16,631	$ 9,647
Accrued warranty	4,773	3,142
Accrued restructuring	575	1,371
Accrued professional services	1,854	1,237
Accrued contingent considerations	2,800	2,775
Customer deposits	3,294	1,164
Other	11,013	7,612
Total	$ 40,940	$ 26,948

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Accrued Warranty

	Nine Months Ended September 29, 2017	September 30, 2016
Balance at beginning of the period	$3,142	$ 3,335
Provision charged to cost of revenue	2,084	1,050
Acquisition related warranty accrual	1,307	—
Use of provision	(1,818)	(1,060)
Foreign currency exchange rate changes	58	(25)
Balance at end of period	$4,773	$ 3,300

Other Long Term Liabilities

	September 29, 2017	December 31, 2016
Capital lease obligations	$ 7,794	$ 8,111
Accrued pension liabilities	5,256	5,957
Accrued contingent considerations	—	2,381
Other	2,018	2,264
Total	$ 15,068	$ 18,713

9. Debt

Debt consisted of the following (in thousands):

	September 29, 2017	December 31, 2016
Senior Credit Facilities – term loan	$ 9,200	$ 7,500
Less: unamortized debt issuance costs	(85)	(134)

Total current portion of long-term debt	$ 9,115	$ 7,366
Senior Credit Facilities – term loan	$ 81,425	$ 63,750
Senior Credit Facilities – revolving credit facility	156,069	10,000
Less: unamortized debt issuance costs	(3,306)	(3,196)
Total long-term debt	$ 234,188	$ 70,554
Total Senior Credit Facilities	$ 243,303	$ 77,920

Senior Credit Facilities

In August 2017, the Company entered into an amendment (the "Third Amendment") to the second amended and restated credit agreement, dated as of May 19, 2016 (the "Second Amended and Restated Credit Agreement"). The Third Amendment increased the revolving credit facility under the Second Amended and Restated Credit Agreement by $100 million, from $225 million to $325 million, and reset the uncommitted accordion feature to $125 million for potential future expansion. Additionally, the Third Amendment increased the term loan balance from $65.6 million to $90.6 million. Under the Third Amendment, the Company is required to pay quarterly scheduled principal repayments of $2.3 million beginning in October 2017, with the final installment of $56.1 million due upon maturity in May 2021. Quarterly installments due in the next twelve months under the term loan amount to $9.2 million and are classified as a current liability on the consolidated balance sheet. The increase in the amount outstanding under the Company's revolving credit facility in the nine months ended September 29, 2017 was related to additional borrowings to fund the WOM, Laser Quantum and ThingMagic acquisitions.

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The Company incurred $0.7 million in financing costs related to the Third Amendment. These costs are presented as a reduction to the debt balances on the consolidated balance sheet and will be amortized over the term of the Second Amended and Restated Credit Agreement.

The Company is required to satisfy certain financial and non-financial covenants under the Second Amended and Restated Credit Agreement. The Company was in compliance with these covenants as of September 27, 2017.

Liens

The Company's obligations under the Senior Credit Facilities are secured on a senior basis by a lien on substantially all of the assets of the Company and certain U.S., U.K. and German subsidiaries as defined in the Second Amended and Restated Credit Agreement and guaranteed by the Company and these subsidiaries. The Second Amended and Restated Credit Agreement also contains customary events of default.

Fair Value of Debt

As of September 29, 2017 and December 31, 2016, the outstanding balance of the Company's debt approximated its fair value based on current rates available to the Company for debt of the same maturity. The fair value of the Company's debt is classified as Level 2 under the fair value hierarchy.

10. Share-based Compensation

The table below summarizes share-based compensation expense recorded in income from continuing operations in the consolidated statements of operations (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Selling, general and administrative	$ 1,336	$ 914	$ 3,911	$ 3,112
Research and development and engineering	59	18	156	82
Cost of revenue	41	56	156	191
Total share-based compensation expense	$ 1,436	$ 988	$ 4,223	$ 3,385

Share-based compensation reported in selling, general and administrative expenses during each of the nine-month periods ended September 29, 2017 and September 30, 2016, respectively, included $0.5 million of expense related to deferred stock units granted to the members of the Company's Board of Directors.

Service-based Restricted Stock Units and Deferred Stock Units

The Company's restricted stock units ("RSUs") have been issued with vesting periods of three, four, and five years and vest based solely on service conditions. Accordingly, the Company recognizes compensation expense on a straight-line basis over the requisite service period. The Company reduces the compensation expense by an estimated forfeiture rate which is based on anticipated forfeitures and actual experience.

Deferred stock units ("DSUs") are granted solely to the members of the Company's Board of Directors, and have been issued as fully vested and non-forfeitable awards upon grant. The compensation expense associated with the DSUs is recognized in full on the respective date of grant.

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The table below summarizes activities relating to RSUs and DSUs issued and outstanding under the Company's Amended and Restated 2010 Incentive Plan during the nine months ended September 29, 2017:

	Shares (In thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2016	635	$ 13.97
Granted	242	$ 25.04
Vested	(206)	$ 14.09
Forfeited	(25)	$ 16.33
Unvested at September 29, 2017	646	$ 17.99
Expected to vest as of September 29, 2017	616	

The total fair value of RSUs and DSUs that vested during the nine months ended September 29, 2017 was $5.2 million based on the market price of the underlying stock on the date of vesting.

Performance-based Awards

The Company granted two types of performance-based awards to certain members of the executive management team: non-GAAP EPS performance-based restricted stock units ("EPS-PSUs") and relative total shareholder return performance-based restricted stock units ("TSR-PSUs"). Both types of performance-based restricted stock units generally cliff vest on the first day following the end of the three-year performance period.

The number of common shares to be issued upon settlement following vesting of the EPS-PSUs is determined based on the Company's cumulative non-GAAP EPS over the three-year performance period against the target established by the Company's Board of Directors at the time of grant and will be in the range of zero to 200% of the target number of shares. The Company recognizes the related compensation expense ratably over the performance period based on the number of shares that are deemed probable of vesting at the end of the three-year performance cycle. This probability assessment is performed quarterly and the cumulative effect of a change in the estimated compensation expense, if any, is recognized in the consolidated statement of operations in the period in which such determination is made.

The number of shares to be issued upon settlement following vesting of the TSR-PSUs is determined based on the relative market performance of the Company's common stock compared to the Russell 2000 Index over the three-year performance period using a payout formula established by the Company's Board of Directors at the time of grant and will be in the range of zero to 200% of the target number of shares. The Company recognizes the related compensation expense based on the fair value of the TSR-PSUs, determined using the Monte-Carlo valuation model as of the date of grant, on a straight-line basis from the grant date to the end of the three-year performance period. Compensation expense will not be affected by the number of TSR-PSUs that will actually vest at the end of the three-year performance period.

The table below summarizes the activities relating to the performance-based awards issued and outstanding under the Company's Amended and Restated 2010 Incentive Plan during the nine months ended September 29, 2017:

	Shares (In thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2016	29	$ 14.13
Granted	60	$ 28.80
Vested	—	$ —
Forfeited	—	$ —
Unvested at September 29, 2017	89	$ 24.00

The fair value of the TSR-PSUs at the date of grant was estimated using the Monte-Carlo valuation model with the following assumptions:

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	Nine Months Ended September 29, 2017	
Grant-date stock price	$ 24.30	
Expected volatility	28.6	%
Risk-free interest rate	1.44	%
Expected annual dividend yield	—	
Weighted average fair value	$ 33.31	

Stock Options

The fair value of stock options is estimated using the Black-Scholes valuation model. Key input assumptions include the expected option term, the expected volatility of the common stock over the expected term of the options, the risk-free interest rate, and the expected dividend yield. Compensation expense related to stock options is recognized in the consolidated statement of operations on a straight-line basis over the vesting period. No stock options were granted during the nine months ended September 29, 2017.

11. Income Taxes

The Company determines its estimated annual effective tax rate at the end of each interim period based on full-year forecasted pre-tax income and facts known at that time. The estimated annual effective tax rate is applied to the year-to-date pre-tax income at the end of each interim period with the cumulative effect of any changes in the estimated annual effective tax rate being recorded in the fiscal quarter in which the change is determined. The tax effect of significant unusual items is reflected in the period in which they occur. Since the Company is incorporated in Canada, it is required to use Canada's statutory tax rate of 29.0% in the determination of the estimated annual effective tax rate.

The Company's effective tax rate on income from continuing operations of 11.9% for the three months ended September 29, 2017 differs from the Canadian statutory tax rate of 29.0% due to the mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, recognition of net tax benefits associated with uncertain tax positions upon expiration of statute of limitations and conclusion of income tax audits, and other discrete items for the period.

The Company's effective tax rate on income from continuing operations of 11.6% for the nine months ended September 29, 2017 differs from the Canadian statutory tax rate of 29.0% due to the mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, the impact associated with establishing control over Laser Quantum upon the acquisition of an additional approximately 35% of Laser Quantum's outstanding shares, recognition of net tax benefits associated with uncertain tax positions upon expiration of statute of limitations and conclusion of income tax audits, and other discrete items for the period. The Company reported a nontaxable gain of $26.4 million on its previously-held Laser Quantum equity interest and wrote off $1.5 million of Laser Quantum related deferred tax liability, which had a combined 13.7% favorable impact on the effective tax rate for the nine months ended September 29, 2017.

The Company's effective tax rate on income from continuing operations of 31.1% for the three months ended September 30, 2016 differed from the Canadian statutory rate of 28.5% primarily due to the mix of income earned in jurisdictions with varying tax rates and losses in jurisdictions with a full valuation allowance.

The Company's effective tax rate on income from continuing operations of 30.3% for the nine months ended September 30, 2016 differed from the Canadian statutory rate of 28.5% primarily due to the mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, and the impact of other discrete items for the period. The Company received a tax free cash dividend of $2.3 million from Laser Quantum, which had a 1.9% favorable impact on the effective tax rate for the nine months ended September 30, 2016.

The Company maintains a valuation allowance on some of its deferred tax assets in certain jurisdictions. A valuation allowance is required when, based upon an assessment of various factors, including recent operating loss history, anticipated future earnings, and prudent and reasonable tax planning strategies, it is more likely than not that some portion of the deferred tax assets will not be realized.

NOVANTA INC.

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AS OF SEPTEMBER 29, 2017

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12. Restructuring, Acquisition and Divestiture Related Costs

The following table summarizes restructuring, acquisition and divestiture related costs in the accompanying consolidated statements of operations (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
2016 restructuring	$ —	$ (1,621)	$ 186	$ 2,955
2011 restructuring	—	—	14	108
Total restructuring and divestiture charges	—	(1,621)	200	3,063
Acquisition and related charges	3,834	786	6,032	2,765
Total restructuring, acquisition and divestiture related costs (gain)	$ 3,834	$ (835)	$ 6,232	$ 5,828

2016 Restructuring

During the third quarter of 2015, the Company initiated the 2016 restructuring program, which included consolidating certain of its manufacturing operations to optimize its facility footprint and better utilize resources, costs associated with discontinuing its radiology product line and reducing redundant costs due to productivity cost savings and business volume reductions. The Company substantially completed the 2016 restructuring program during the second quarter of 2016. As of September 29, 2017, the Company incurred cumulative costs related to this restructuring plan totaling $6.4 million. The Company expects to incur additional restructuring charges of $0.2 million to $0.3 million related to the 2016 restructuring plan.

The following table summarizes restructuring costs for each segment and unallocated corporate and shared services related to the 2016 restructuring plan (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2017	September 30, 2016	September 29, 2017	September 30, 2016
Photonics	$ —	$ 45	$ —	$ 813
Vision	—	(1,728)	185	1,730
Precision Motion	—	—	—	106
Unallocated Corporate and Shared Services	—	62	1	306
Total	$ —	$ (1,621)	$ 186	$ 2,955

2011 Restructuring

In November 2011, the Company announced a strategic initiative (“2011 restructuring”), which aimed to consolidate operations to reduce the Company’s cost structure and improve operational efficiency. As part of this initiative, the Company eliminated facilities through the consolidation of certain manufacturing, sales and distribution facilities and the exit of Semiconductor Systems and Laser Systems businesses. The Company substantially completed the 2011 restructuring program by the end of 2013. In March 2016, the Company sold its previously exited Laser Systems facility located in Orlando, Florida for cash at the net carrying value of $3.5 million. In December 2016, the lease agreement for the Company’s previously exited laser scanner business facility was terminated.

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Rollforward of Accrued Expenses Related to Restructuring

The following table summarizes the accrual activities, by component, related to the Company's restructuring plans recorded in the accompanying consolidated balance sheets (in thousands):

	Total	Severance	Facility	Depreciation	Other
Balance at December 31, 2016	$1,736	$ 611	$1,111	$ —	